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C O N F I D E N T I A L SECTION 01 OF 06 PRISTINA 000810

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KV, YI

SUBJECT: KOSOVO: EFFECTS OF POSSIBLE SERBIA ECONOMIC
BLOCKADE POST-INDEPENDENCE

REF: A. PRISTINA 542

[1](#)B. PRISTINA 757

[1](#)C. PRISTINA 786

Classified By: COM TINA KAIDANOW FOR REASONS 1.4 (B) AND (D)

[1](#)1. (C) SUMMARY: Despite negative consequences for its own economy, Serbia appears determined to implement an economic blockade against Kosovo when independence is declared. While the length and degree of a blockade is impossible to predict, complete closure of every Serbia-Kosovo checkpoint to all forms of transport could be viewed as the worst case scenario, and the impact of these closures would be felt almost immediately. We anticipate some local hoarding of food, bottled water and cash until goods can be re-routed, most likely through Macedonia. Severe shortages of food and fuel are unlikely, however, even if life in Kosovo is certain to become more expensive and consumer goods less available. Kosovars have demonstrated considerable resilience in response to retaliatory actions from Serbia in the past, and they will likely find alternative resources to support themselves in the event of a blockade. Our European Commission colleagues share this assessment and do not plan to stockpile commodities, though they will maintain an active "watching brief" and say they can muster a rapid response to any emergency within 24-72 hours.

[1](#)2. (C) SUMMARY (cont,d): Serbia has several other measures at hand to make life generally more difficult and frustrating for Kosovo, magnifying the effects of a blockade. Cutting off Kosovo from shared telecommunications cables, the power grid, and water from the Gazivoda reservoir (though the latter in particular is a deeply complex issue with impact on Serbs and Albanians alike) are all within Serbia's capacity. The closing of borders, in addition to economic hardship, would contribute to physical isolation as well. Alternate overland roads through Macedonia, Montenegro and Albania can be arduous and are often blocked by rockslides, heavy snowfall, and fog during the winter months. Scheduled commercial air traffic into Kosovo might be cancelled for several days immediately following an independence declaration, but will likely resume as soon as the ground

environment is determined stable. Our take is that Kosovo in the short-term would be able to weather these obstacles without serious hardship. The long-term effects of a sustained blockade, however, could be more damaging to Kosovo's economy. A significant decrease in investment, imports, and the subsequent lack of employment generation could result in the loss of an entire year of growth. Re-routing cargo to alternate border checkpoints, if well managed, should diminish the severity of a blockade. END SUMMARY.

SHORT-TERM EFFECTS OF A COMPLETE BLOCKADE

¶3. (C) In consultation with USAID advisors, Embassy Belgrade and others, a prediction of the complete closure of every checkpoint, blocking all movement of goods and people to and from Kosovo at the Administrative Boundary Line (ABL) is the agreed worst-case scenario. Statistics from the Office of the Prime Minister indicate that just over one-third of Kosovo's total imports come from or through Serbia, with an approximate value of 546 million euro. Imports originating within Serbia amount to 200 million euro, or 12 percent of all cargo coming through the ABL checkpoints, most of which are consumer products. Almost no fuel comes through the ABL crossings. These figures include the importation of wheat and flour, which were subject to a general export ban by the Serbian government in mid-2007 due to Serbian grain shortages. This ban is still in effect, reducing the total percentage of Serbian-produced imports to around 9 percent, which is small in terms of overall consumption. Kosovo exports about 30 million euro worth of goods (7 percent of total exports) through the ABL checkpoints.

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¶4. (C) Assuming that end-restrictions (i.e. denial of passage based on final destination of cargo) are not placed on goods transiting through Serbia, non-Serbian imports coming through the ABL checkpoints could be re-routed to alternate crossings via Albania, Montenegro and Macedonia. Each of these countries has one cargo checkpoint with Kosovo. Inclement weather, rock slides and generally poor road conditions make it possible that all three crossings could be closed for significant periods during the winter months. The transit point from Albania has improved significantly over the past year, allowing for passage of small trucks and a wide array of commodities, but still cannot accommodate large capacity tractor-trailers. If Serbia enforces end-restrictions on transiting goods, ground transportation would have to be routed around Serbia, through Romania and Bulgaria, before reaching the Kosovo-Macedonia border. Thus, in addition to delays in delivery, significant transport costs could be added to the import of goods to Kosovo.

¶5. (C) The Hani i Elezit/General Jankovic crossing with Macedonia is by far Kosovo's most important overland link and the most accessible alternative. This checkpoint is already heavily utilized for cargo in and out of Kosovo, including for KFOR supply operations, and is accordingly plagued by general congestion. USAID advisors estimate that 40 percent of all goods imported to Kosovo pass through Hani i Elezit. If all goods passing through Serbia were re-routed to this checkpoint, 70 percent of Kosovo's imports would be fighting to enter through one crossing. Delays could be considerable, lasting weeks and possibly even longer. Currently, the Hani i Elezit cargo clearing facility is operating at 70 percent capacity. To accommodate the increase in traffic, trucks could be moved to an inland facility to clear customs. However, the assistance of Macedonian customs officials is required to facilitate the increased cargo flow into Kosovo. Kosovo's customs chief says he has contacted his Macedonian counterparts about addressing this scenario, but admitted that active cooperation between the two organizations has not been forthcoming. (Note: USOP will pursue this issue with counterparts at Embassy Skopje.)

Reaction of Kosovo Customs

16. (C) The Director General of the Kosovo Customs Service, Naim Huruglica, told us recently that if Serbia completely closes the ABL checkpoints, Customs is prepared to re-deploy officers to the alternate border crossings within one week. Huruglica added that the railway, with one international connection to Skopje, and Pristina airport, which currently handles about 8 percent of all goods entering Kosovo, will also be crucial in maintaining the flow of goods. (Note: UNMIK reports addressing possible consequences of an independence declaration do not foresee airport operations adversely affected. However, it is possible that commercial flights to and from Kosovo could be halted for several days while stability on the ground is assessed. Whether airlines resume flights will depend largely on the governments of their respective home countries, and possibly their insurers.) The maximum capacity of Kosovo's railway system is 8-10,000 tons per day, but the railway's managing director maintains that capacity can be increased by borrowing railway wagons and locomotives from Macedonia, a prospect that would also need to be further explored. In addition, according to our European Commission colleagues, European assistance funding has recently been used to improve uploading capacity for railway cargo in Macedonia and downloading capacity at the railway terminus in Fushe Kosove (just outside Pristina), potentially increasing the efficiency of transit via rail as an alternate mode of transport. Substantial fuel reservoirs exist at the Fushe Kosove terminus, as well, for further redistribution to other parts of Kosovo.

Effects on the Consumer

17. (C) Consumer goods shortages and an increase in prices

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could well provoke some hoarding of food, water and cash in the first few weeks after a blockade is declared. Rising fuel costs and higher transportation expenses from re-routing imports may not only increase the cost of consumer goods, but could also harm the competitiveness of Kosovo exports. Transport delays could lead to confidence issues if Kosovo businesses cannot deliver on their contractual agreements. Accurate statistics on inventories are not readily available, but the wheat and flour ban-produced shortages indicated only two months of stock available. Current inventories are probably significantly lower, due to inadequate time for businesses to re-build their stocks since the ban went into effect.

18. (C) Kosovars could see substantially higher consumer prices, particularly for foodstuffs. There will almost certainly be short-run profit-taking from individuals seeking to exploit immediate shortages. As long as the non-ABL checkpoint routes remain reasonably free of blockages, extreme shortages of food are not likely, but availability of consumer goods could be reduced. Given that the bread crisis resulting from the wheat and flour export ban was absorbed quickly and with little difficulty, Kosovo appears capable of absorbing even greater economic shocks that could result from a blockade.

Currency Availability

19. (C) The physical availability of currency, notes and coins could be an issue if supply routes are blocked. The cash deposit ratio in Kosovo is 11 percent, with an estimated 65 million euro in cash-on-hand. Kosovo could face the possibility of running out of cash if a run on banks is made immediately after independence. The Kosovo Central Banking Authority (CBAK) intends to increase cash holdings before the end of the year, due to the uncertainty of any independence timing and unforeseen initial demand. CBAK expects to see some lines at ATMs, but otherwise extreme cash shortages are not anticipated.

Business Community Anticipates Blockade

¶10. (C) The Kosovo business community appears already to be planning for a blockade. It is actively seeking out alternative suppliers in neighboring Macedonia, Montenegro and Albania, and even casting its net wider to include Turkey, Italy, Greece and the U.S. USOP has received three inquiries about importing wheat and cooking oil from the U.S., in an apparent pre-emptive move to alleviate possible shortages and delays from a blockade. The president of the Alliance of Kosovar Businesses, Agim Shahini, recently declared Kosovo prepared for any trade embargo implemented by Serbia. What local businesses cannot supply, Shahini asserted, the grey market will provide.

¶11. (C) It is likely Kosovo Serbs will be able to continue trading during a full blockade. Serb enclaves have been exempt from the wheat and flour export ban, obtaining special permits from Belgrade to receive shipments. This could place the enclaves in an excellent position to re-sell consumer products to Kosovo Albanians for a substantial profit, fulfilling the prediction of the grey market stepping in to meet consumer needs. In a slightly different scenario, Serbia could choose not to cut off trade to northern Kosovo, increasing the potential for smuggled goods to enter Kosovo and move illicitly further south. Safet Gerxhaliu, head of the Kosovo Chamber of Commerce, claims that grey market trade is already in the neighborhood of 200 million euro per year.

POSSIBLE ANCILLARY EFFECTS

¶12. (C) Serbia could employ a number of additional measures to make life generally more difficult and frustrating for Kosovo. The multiplying effect of these measures will depend on Belgrade's decision to implement a full or partial

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blockade and how strictly the blockade is enforced on the ground.

Energy

¶13. (C) Kosovo is connected to Serbia's electrical grid, and it imports additional power through these lines during peak winter months. Serbia could cut Kosovo completely out of the grid, though this would also cut electricity to the Serb enclaves. Serbia has a contractual agreement to supply power to Greece, Macedonia and Albania, routed through Kosovo. Eliminating Kosovo from the grid also means cutting off Serbia's own customers. Nevertheless, the likelihood of a cutoff is significant, and could substantially raise the cost of electricity imports, which would have to be purchased on the regional spot market rather than through existing, lower-cost arrangements via Serbia. Refs B and C provide more information about the current energy situation in Kosovo, including the broader implications of a Serbian power cut.

Water

¶14. (C) Serbia could attempt to tamper with the extensive water system that emanates from the Gazivoda reservoir, located in the northern Serb-majority municipality of Zubin Potok. Gazivoda supplies drinking and some irrigation water to northern Kosovo (including both Serb-majority areas and limited Albanian-majority areas like Vushtrri and Drenas), and is the only water source with sufficient capacity for operation of essential assets such as the Kosovo Electric Company (KEK), though potable water for Pristina and other areas of Kosovo is sourced primarily from the nearby Batllava and Badovc reservoirs (Ref A). Gazivoda is an additional back-up drinking water source for Pristina but has not yet been used for this purpose, despite severe droughts this summer.

¶15. (C) The water delivery system is complex; as an example,

potable water is actually pumped from Gazivoda and transported via a canal system to a water treatment plant in south Mitrovica before being returned to northern Kosovo as drinking water. Multiple pumping stations, viaducts and tunnels along the 50 km canal route that sends water further south (notably, to cool the KEK plants as they operate) could be potentially vulnerable, though sabotage could have an impact on Serb communities in the north, at least in the immediate term. Local experts also tell us that acts of sabotage could, in the main, be quickly repaired unless there were multiple system failures. KFOR and UNMIK are discussing protection of the water delivery system, but protection of all key nodes would be a tall order. The EU is also conducting technical studies of the Gazivoda reservoir and water delivery systems. Septel will report on these water-related issues in more detail.

Movement of People

¶16. (C) Serbia currently refuses entry to vehicles with Kosovo-issued license plates and is not expected to change this policy post-independence. Kosovar vehicles would likely continue to use third-country license plates to enter Serbia, if the travel portion of the blockade is not in full effect. According to UNMIK Police statistics, roughly 2,000 vehicles enter and exit Kosovo through the ABL checkpoints daily, along with 5,000 to 6,000 persons checked each way. Given seasonal fluctuations and some statistical unreliability, these data indicate a significant amount of traffic will be halted under a full blockade.

Telecommunications

¶17. (C) According to UNMIK reports, 40 percent of international incoming telephone traffic passes through fiber optic lines between Serbia and Kosovo, using Serbia's

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international dialing code. Belgrade could conceivably cut off telephone landlines and interfere with the international dialing code, in an attempt to isolate Kosovo. Some international outbound traffic is also being routed through Serbia. Traffic both ways could be re-routed through other channels to maintain international connectivity, although it should be noted that Serbia makes a profit from termination charges for all calls ending in Kosovo on its fixed lines. The mobile network already operates independently of Serbia. Some cell towers in northern Kosovo are located on private property, which, if confiscated, would disrupt mobile service in northern Kosovo only.

LONG-TERM EFFECTS

¶18. (C) USAID advisors foresee significant long-term effects from a blockade, particularly if in full force for several months or more. The 2008 Kosovo budget includes large public sector capital expenditures, partially based on the current government surplus. If funds for these projects are redistributed to meet emergency needs, such as subsidizing consumer goods and electricity, real GDP growth could decrease from a projected 8.1 percent to 3.4 percent. If investment imports continued to be blocked and alternative sources of capital expenditures did not materialize, investment projects and employment creation would not occur. GDP could drop as low as 0.9 percent, which is effectively the loss of an entire year of growth.

¶19. (C) Customs revenues are the primary contributor to Kosovo's budget. According to statistics from the Office of the Prime Minister, the revenue collected at the ABL checkpoints is estimated at 89 million euro per year. This comprises about 17 percent of revenues collected at all border checkpoints throughout Kosovo. UNMIK estimates that the initial drop in revenues from the ABL closures will be temporary until alternate transportation routes are established. However, any drop in budget revenue would mean

less cash flexibility overall. This could be of particular concern regarding electricity needs, in addition to the possible decline in economic growth. If KEK is unable to supply enough power during the peak winter months, Kosovo could find itself without adequate cash reserves to purchase additional energy on the spot markets and would have to delve into the budget surplus to meet this need. Kosovo Customs Director Huruglica noted that total revenue collection for 2007 is expected to exceed targets by as much as 20 percent (approximately 70 million euro above projections). Huruglica offered the opinion that this surplus could offset any potential revenue drop from the ABL checkpoint closures, though again this would hinder use of the surplus for other economic objectives.

European Commission Prepared, But Not Alarmed

¶20. (C) Our European Commission colleagues share our overall assessment that Serbian measures are likely to cause difficulties, but not to derail the Kosovo economy. Acting EC head of office Renzo Daviddi told USOP that he had just been to Brussels the week of December 3 to review crisis contingencies, but was satisfied that there was no need to move either people or commodities to the region in advance of a Kosovo declaration of independence. The EC, he noted, has crisis management and rapid response mechanisms that can respond within 24-72 hours in the event of an emergency, though Daviddi said he was convinced that Kosovo would not experience large scale economic problems as the result of a blockade. He cited three potential areas for concern, including water supply (which he termed a security issue), electricity (which he asserted was best dealt with via political understandings with Macedonia and Montenegro on assured transmission of electricity via their grids, though he acknowledged the cost of imports could be considerably higher than under current arrangements), and the free movement of people. He foresaw, as in our analysis, possible

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price increases and shortages of some commodities, though not massive ones, and believed that smuggling and rerouting of goods would go a long way towards ameliorating the shortages.

Daviddi also previewed the strong possibility that the EC would make available 50 million euro (previously set aside for Kosovo budget support in the event of a budget deficit) for use by Kosovo as an emergency fund, though the decision had not yet been taken in Brussels.

¶21. (C) COMMENT: How extensively Serbia will choose to implement, or strictly enforce, a blockade will vary the level of stress to Kosovo's economy. We anticipate Serbia will feel the need to make a strong statement, one that is physically felt by Kosovars, in response to any declaration of independence. An economic and travel blockade, even if implemented to the maximum extent possible, will certainly hurt the Kosovo economy but not cripple it. USAID advisors predict that after the initial shocks are absorbed, Kosovo's economy will slowly normalize. Kosovars have learned to be extremely resourceful during past crises, continuing to trade with Serbia on the ground even during conflict. The possibility that economic and business interests will prevail over political maneuvering in this instance is also fairly likely, though the exigencies of the gray market will increase costs to the Kosovo consumer. The potential for long-term damage of a full boycott to Kosovo's growth opportunities could, however, be more significant. Kosovo authorities are beginning slowly to grapple with these issues, and we are encouraging them to think through the implications of Serbian measures. Stockpiling commodities does not seem like a necessary measure at this point, though we and our EU counterparts are continuing to evaluate the situation and will advise further. END COMMENT.

KAIDANOW